



Minutes of the Advisory Panel to DEFAC
Haslett Armory Dover, DE – October 20, 2017

Attendance:	Chairperson, Mr. Michael Houghton			P
K. Lewis	P	H. McDowell		P
E. Ratledge	P	Q. Johnson		P
K. Simpler	P	M. Ramone		P
J. Bullock	P	A. DelCollo		P
R. Geisenberger	P	R. Johnson		P
M. Jackson	P	S. Malfitano		A
M. Morton	P	D. Smits		P

Support and Staff Present:

A. Loiaconi, A. Aka, R. Goldsmith, J. Johnstone, N. Roby, D. Roose, S. Bailey, A. Jenkins, B. Scoglietti, S. Scola, D. Burris, B. Fahey, S. Steward, M. Marshall, A. Dillione

Members of the Public:

P. Morrill, B. Doolittle, E. Goldner, N. Cook

1. Call to Order

Mr. Houghton called the meeting to order.

2. Topical Recap and Requests

Mr. Houghton discussed the minutes and suggested they remain draft minutes until members have had more time with the document. Mr. Houghton recapped the prior meeting discussion of historical budget practices and issues and PEW's overview of other state practices regarding rainy day funds.

Mr. Jamie Johnstone, Economic/Fiscal Analyst with the Department of Finance, addressed a request to assess whether having bi-annual budget cycles would have solved Delaware's volatility problems. Available research showed that all but two states effectively use annual budgets. In bi-annual budget states volatility is increased due to greater forecast volatility.

Mr. David Roose, The Director of Research and Analysis, discussed an analysis of NASBO data on 5-year revenue growth trends in all fifty states and D.C. compiled by the Department of Finance. The data showed that Delaware grew similar to surrounding states and slightly slower than the national average if outlier (extraction tax) states are removed from the sample.

Mr. Simpler asked this sort of analysis could be made over a longer period.

Representative Ramone asked if a similar analysis was done around spending growth over the period. Mr. Johnstone responded that the balanced budget requirement means that expenditure growth is roughly tied directly to revenue growth.

Representative Ramone asks if this includes revenues from legal settlements. Mr. Johnstone stated that this covers anything that was part of the General Fund. Director Jackson noted that some legal settlements are required to be spent in specific ways by the settlement agreements and some portions are directed to Special Funds.

Secretary Geisenberger notes that doing a 50 state comparison at a detail of the level to include settlement payments would be difficult.

3. The Charge of the Advisory Panel

Secretary Geisenberger discussed House Joint Resolution No. 8's charges. Secretary Geisenberger noted that other taskforces have made previous recommendations surrounding Delaware's broad revenue portfolio issues as well as concerns with specific revenue categories. While the Panel is within its mandate to consider expenditures as a whole, Secretary Geisenberger mentioned that the challenges presented by specific expenditure categories are being considered by a variety of other taskforces. Secretary Geisenberger states that beyond the specific re-evaluation of the 2015 DEFAC Advisory Council on Revenues report, the mandate asks the Panel to look at the existing processes and procedures around the Budget Reserve Account and the concept of a budget stabilization fund.

Treasurer Simpler notes that it may be helpful to define a common lexicon to keep discussion on point. In particular, there is a distinction between discussing the level versus the trend in both revenues and expenditures. Treasurer Simpler states that the mandate asks the Panel to focus on the trends over levels, whether the current budget process allows the State to remain on a sustainable path according to economic indicators, and whether predictable, cyclical noise is being properly handled given present fiscal controls.

Mr. Ratledge notes that revenue sufficiency is also important to consider given predictable growth in current commitments; such as pension liability.

Mr. Houghton states that some of this is likely baked in with future projections and that the Panel's mandate is instead to focus on determining some construct that would smooth out the noise in the entire budget; rather than getting into the weeds of particular expenditure and revenue categories. Mr. Houghton reiterates that a variety of groups are studying specific issues.

Senator McDowell states that budget stabilization is currently imposed annually depending on the current budget context. He notes that unclaimed property is a revenue category where revenue has been actively welcomed into the budget. Cutting done in last year's budget process may have shocked some individuals, but also allowed for the elimination of less effective programs. Mr. McDowell discussed a variety of economic trends related to capital markets and wage growth in Delaware.

Representative Johnson notes that one of his visions for the Panel is to provide financial expertise to legislative members who are not as practiced in business and/or the budget process. The prior Advisory Council on Revenues offered a list of less volatile revenue options, but that the most recent budget solution neglected those solutions in favor of more narrow and volatile sources of revenue. Mr. Johnson notes that all these committees have been created to provide more objective recommendations for budgetary questions and to provide a means for holding Delaware politicians accountable for their choices.

4. Pew Charitable Trusts: State Case Studies

Stephen Bailey, Senior Associate from The Pew Charitable Trusts, gave a presentation covering the mechanics and history of rainy day funds in Idaho, Massachusetts, Virginia, and Tennessee. Mr. Bailey states that the four examples cover a variety of structures in terms of deposit rules, withdrawal rules, and caps as well as demonstrate the pitfalls to be avoided in crafting and using a stabilization fund. These four states were chosen because of their clear practical rules, the quality of their accounting data for tracking purposes, and the inclusions of state's that have experienced some of the downsides of stabilization funds.

Mr. Houghton commented that Virginia's solid history of rule following is surprising given a withdrawal rule which allows fund use as a result of revenue forecast error. Mr. Houghton notes such a structure for withdrawal rules appears to leave room for discussion about using the fund.

Sen. DelCollo asks about the contractual or budgetary mechanisms that allow Massachusetts to set aside settlement dollars in their rainy day funds.

Mr. Houghton states this presentation would suggest you can formulate a variety of potential withdrawal rules, but that it is important the budget process is disciplined and involves responsible rule following.

Mr. Houghton notes the presentation makes clear that bond rating downgrades as seen in Massachusetts represent one real check on political uses of stabilization funds.

Secretary Geisenberger notes that rating agencies have looked favorably upon Delaware's refusal to carry a negative cash balance into the next year. This is not strictly required by statute, but Delaware's legislature and executive administrations have taken the disciplined measure, such as hiring freeze, to ensure this does not occur. Secretary Geisenberger notes that having a smoothing fund may have reduced the scale of action necessary in the past.

Treasurer Simpler states that there is a fundamental difference between receipts, forecasts, and the economic cycle. Treasurer Simpler suggests one conclusion to be drawn from Pew's presentation is that rules that rely on objective, independent measures help ensure budgetary actions remains in line with the underlying economy.

Mr. Houghton asked Mr. Bailey to assess which states have had the best experience, and how much of that success was relate to culture as opposed to rules.

Mr. Bailey states that whatever implementation ensures the rules are followed as closely as possible is the best implementation according to credit rating agencies. Pew generally advocates for rules that save based on a trigger as opposed to from a surplus in order to prioritize savings over other options that might become available. Mr. Bailey states Pew's position is agnostic on rule structure as long as those rules clearly define extraordinary revenue growth.

Mr. Bailey, in response to a question from Sen. DelCollo, states that the use of fiscal controls based on a specific revenue stream versus controls measured through overall revenue trends depends more on buying from people engaged in the process than one format being better than the other.

Rep. Johnson notes that the Joint Finance Committee (JFC) has built a culture that does well in following the rules at present regardless of the budget situation at hand. The role of this and other committees should be to improve the budget situation the JFC faces each year.

Mr. Bailey, in response to a question from Mr. Houghton, states that broad and narrow deposit rules are both sufficient for building reserve so long as the structure of the rule results in sufficient funds being stored. To this end, the modelling of potential rules is essential to making any implemented rules work.

Rep. Ramone suggests a blended funding rule of both broad and narrow fiscal controls.

Secretary Geisenberger suggests that staff build a presentation on the various features, pros, and, cons of all the potential budget smoothing constructions. This panel should agree upon the target principles required for a good budget smoothing procedure and then find constructions that fit those principles.

Sen. McDowell notes that forecast rules would have to specify which forecast was used for comparison. Sen. McDowell requests that the most accurate revenue projections possible be provided as soon as that can be produced.

Secretary Bullock asks if some examples of states with recent revenue trends similar to Delaware's could be presented. He notes that the Virginia example is nearly identical and thus a relevant comparison.

Secretary Geisenberger asks that the council consider some states that are comparable in actual revenue trends and in personal income growth in recent history.

Mr. Houghton states the sense that the Panel members are in agreement that a revenue stabilization fund would be worth establishing.

In response to Secretary Bullock's concerns about how slow Delaware revenues have grown recently, Representative Johnson notes, if the work of the prior Advisory Council on Revenue were enacted, the stabilization discussion would likely be less academic. This Panel has then been asked to work backwards in establishing a stabilization fund before revenue sufficiency has been addressed.

Representative Ramone notes that this discussion should include reconfiguration of existing budget controls and the existing revenue portfolio, as well as the addition of new controls such as a stabilization fund.

Mr. Houghton suggests that the next two meetings should be sufficient to consider the board of options and craft a recommendation that considers existing controls and new options. Additional consideration should also be given to the fact that extraordinary events may force Delaware's hand adjusting these measures.

Representative Johnson asks Senator McDowell to comment on the revenue context and budgetary climate that exist when the current Rainy Day Fund was established.

Senator McDowell states the Budget Reserve Account was established because Delaware was in the midst of severe financial issues, but that it was not conceived as being the inaccessible fund it has become.

5. Measuring Delaware's Means and Needs

Mr. Johnstone and Susan Steward, Policy Advisor with the Office of the State Treasurer, gave a presentation covering independent, economic measures of Delaware's potential tax bases and proxies for minimum service provision. Mr. Johnstone briefly discussed growth in regional economic measures that correlate with the growth in various tax bases. Each of these bases shows meaningful volatility, particularly from the mid-90s onward, and the bases exhibit strong directional correlation. Mr. Johnstone notes that whether a state's tax portfolio is structured to capture the specific tax bases driving the national business cycle is heavily influential in that state's revenue growth during said business cycle.

Treasurer Simpler notes that the business cycle slides suggest the budgetary rules and the mix of revenues emphasize in Delaware served the State well in the nineties' business cycle. These rules do not appear to align as well with subsequent business cycles.

Ms. Steward discussed a comparison between the ten-year rolling average of Delaware revenues and similar rolling averages for economic measures of price plus population growth as a proxy for baseline cost growth. The rolling revenue average shows a significant downward trend while trends in price changes, such as the national State and Local GDP Deflator and regional CPI-U, are more consistent. Ms. Steward states that the 10-year rolling proxies for "needs" have historically been well below the 10-year trend revenue growth. A comparison of a regional measure of "needs" like regional CPI plus population growth correlates strongly with the more national measure of "needs" such as the State and Local GDP Deflator.

Treasurer Simpler states that the rolling averages presented show Delaware specific means as likely sufficient to provide pleasant levels of growth in services, and that slightly lower levels of growth seen in proxies for "needs" could also potentially provide satisfying growth in service provision.

Mr. Ratledge notes that the history presented corresponds with the peak earning years of Baby Boomers, and that projecting the same trend forward would likely be inaccurate. Mr. Ratledge states that the demographic distribution of the future populace of Delaware will result in a significant portion of personal income as transfer payments, like Social Security payments, which do not generate much, if any, tax revenue.

Mr. Simpler notes we may have an infrastructure built on the assumption of higher revenue growth, but that independent measures of means and needs may suggest a lower growth rate for service provision should be sustainable.

Mr. Houghton agrees, but notes that the tough decisions involved with that adjustment will not be made in this Panel.

Senator McDowell suggests including a measure of the county governments' means and needs and whether they have bandwidth to increase their burden.

Mr. Johnstone notes that for the purpose of these independent measures, the county-level means and needs should be driven by the same measures

Senator DelCollo states this presentation makes clear the importance of imposing a rational fiscal control related to the State's relative means and needs; in addition to the current discussion around a budget stabilization fund.

Representative Johnson notes that a smoothing fund could impose its own fiscal control given the annual balanced budget requirements.

6. Discussion

Mr. Houghton states that staff is tasked with putting together additional analyses and recommendations and Pew will provide more information about more comparable states.

7. Public Comment

Mr. Doolittle, an advocate for children, states he is a strong support of a counter cyclical fund which would be stronger if its triggers were economically based. He reiterated his concern that using unencumbered funds as a source of revenue is very problematic and amplifies the available appropriation level variance. Mr. Doolittle states that the Panel will be missing a significant opportunity if the mechanisms developed do not address this issue.

Ms. Goldner, from Hope Street DE Inc., states her concerns about how the most recent economic crash and slow recover have negatively impacted mental health and substance abuse rates in Delaware. She emphasizes the importance of stimulating the Delaware economy and empowering people to make things in order to improve aggregate mental health. Ms. Goldner notes that doing this would have a variety of cost savings benefits for the State.

Secretary Geisenberger notes that a recent Moody's study stress-testing state-level budget reserves as a means toward weathering the next recession should be analyzed by Panel members before the next meeting.

8. Adjournment